THE INCOME-TAX LAW OF THE STATE OF MISSOURI, AS AMENDED AUGUST 3, 1921

I. INTRODUCTION

Until the passage of the income tax law of Wisconsin in 1911 and the Federal Income-Tax Law of 1913, the opinion of the majority of the tax specialists of the country was that a state income tax was impractical. Mr. D. O. Kinsman, writing in 1903, stated:

> The experience of the states with the income tax warrants the conclusion that the tax, as employed by them, has been unquestionably a failure. It has satisfied neither the demands for justice nor the need of revenue. . . . . A careful study of the history of the tax leads one to the conclusion that the failure has been due to the administration of the laws. This conclusion is borne out by both the admissions of the advocates and the assertions of the opponents of the tax, and is corroborated by the reports of the tax commissions.[1]

K. K. Kennan, writing seven years later, emphasized the administrative difficulties which must be overcome before a state income tax can be successful.[2] In his book, *The Income Tax* published in 1911, Professor Seligman agreed with Mr. Kinsman. By 1914, he recognized the success of the Wisconsin law but still believed that the income tax would be successful in only a few states.[3]

Attention should be called to the fact that the objections to state income taxes were based upon the difficulties of administration and not upon questions of principle. In fact Mr. Kinsman states that it is generally agreed that one's ability to support the government is best measured by his income.[4]

The revived interest in the income tax during the last twenty years has been due to two main factors, viz., (*a*) the universal dissatisfaction with the general property tax as an equitable

[1] D. O. Kinsman, *The Income Tax in the Commonwealths of the United States*, pp. 116 f.

[2] K. K. Kennan, *Income Taxation.*

[3] E. R. A. Seligman, *The Income Tax* (1914), p. 429.

[4] Kinsman, p. 116.

means for distributing the burdens of state government; and (*b*) the rapidly increasing demands for funds made upon the state treasuries.

The general property tax falls upon three main classes of objects: real estate, tangible personalty, and intangible property. While there was severe criticism of the tax on real estate due to unequal undervaluation on similar property in adjoining taxing districts—and in fact often in the same districts—and dissatisfaction with the taxing of tangible personal property due to exemption of certain classes, undervaluation of some and failure to reach others at all, because of a failure on the part of the taxpayer to report to the assessor, the greatest measure of criticism was directed against the manner of operation of the tax in so far as intangible personal property, such as money, credits, and securities, was concerned. The one uniform result found in all states was widespread escape of intangibles from taxation. Taxpayers were unfriendly toward the tax in the first place and found the law relatively easy to evade in the second place. As an illustration of how the law was evaded, the following illustrations are given: In Ohio the deposits in all the banks was $500,000,000, yet the amount of money returned for taxation in 1906 was only $59,984,000 or slightly less than 12 per cent. In Illinois in 1897, Cook County, which had one-third of the real estate valuation of the entire state and more than one-third of the population, returned one-tenth of the money assessed for taxation. In the capital city of the state of Washington, in 1903, a widow who had received $2,000 of insurance money after the death of her husband returned more money for assessment than all the other taxpayers, including corporations.[1]

Various schemes for eradicating, or at least moderating, the iniquities of the general property tax have been suggested, including various forms of classified property taxes, modified faculty taxes, and income taxes. However, as was stated above, state income taxes were regarded as failures until after the success of the Wisconsin law. Immediately following the success of that law a great wave of enthusiasm for state income

[1] C. J. Bullock, *Selected Readings in Public Finance*, pp. 298 f.

taxes swept over the country. It was hailed by many as a substitute for the general property tax and perhaps a solution of our taxing problem for all time. This feeling was further augmented by the success of the federal income tax law in 1913. This feeling of enthusiasm has somewhat subsided, at least to such an extent that the state income tax is no longer regarded as a panacea for all tax difficulties. Instead of being a substitute it should be supplementary to the property tax with intangibles exempted. No doubt the best general plan for a state tax system is that proposed by the National Tax Association, which is composed of three types of taxes: a personal income tax, levied at the place of domicile; a property tax upon the tangible property, levied where the property has its situs, and a business tax levied on all business carried on in the state.

The following discussion deals, in some detail, with Missouri's experiences with the income tax. The present law marks the second step in this state's use of the tax.

II. A BRIEF HISTORY OF INCOME-TAX LEGISLATION IN MISSOURI

The legislature of Missouri enacted an income tax law during the Civil War period, 1861–65. This was essentially a war tax. At first it was applied to salaries in excess of $800, and to incomes "derived from public stocks, bank stocks, stocks of chartered companies or from other property, real or personal, not taxed in the state." The rate was thirty-two cents on the hundred dollars, which rate was lowered in 1864 to one-fifth of 1 per cent. The exemption was reduced at the same time from $800 to $200. In 1865 the rate was raised to 3 per cent on salaries of officials exempt from military duty by reason of their office and 2 per cent on other salaries; the exemption was raised to $600, and it was provided that the sum produced by the tax should be paid into the Union Military Fund. In case of failure to make a sworn return of the amount of income the assessor was authorized to value the income at double what he had reason to believe it to be.[1]

This law was repealed in 1865 and it was not until 1917 that Missouri again entered the ranks of the states having income

[1] K. K. Kennan, *Income Taxation*, p. 222.

tax laws. The law of 1917 provided for a tax of one-half of 1 per cent upon net incomes from all sources in excess of $3,000 for single persons and $4,000 for married persons, for the last half of the calendar year of 1917 and each calendar year thereafter. The same law also provided for a tax on the net income of both foreign and domestic corporations at the same rate.[1] It may be noted also that the income tax law contained a provision for the offset of all property taxes paid.[2]

This law was amended by an act approved May 6, 1919,[3] which provided that the rate of taxation upon net incomes above $1,000 for single persons and $2,000 for heads of families for the calendar year of 1919 and in each calendar year thereafter should be 1½ per cent. The rate on net incomes of corporations was raised to 1½ per cent at the same time. As a result of the repeal of the section of the 1917 law which permitted a person to present a receipt for state taxes on property in any year in payment of income taxes assessed against him during the given year, the income tax became an addition to instead of a substitute for the property tax.[4]

The administration of this law was somewhat affected by a decision of the Missouri Supreme Court, delivered during the summer of 1920. The amendment to the 1917 law was claimed to be invalid because in violation of the constitutional provision specifically prohibiting the passage of any *ex post facto* law, or law impairing the obligation of contracts or "retrospective in its operation." The court held that the law did violate these provisions, not *in toto*, however, but to the extent of the increase in the rate added by the amendment. The tax was held good at the old rate up to the time of the taking effect of the amendment, and at the increased rate for the balance of the year.[5]

[1] Laws of Missouri, 1917, p. 524.

[2] Alzada Comstock, *State Taxation of Personal Income*, p. 182.

[3] Laws of Missouri, 1919.

[4] Professor Loeb, *Bulletin National Tax Association*, II, No. 9, 230.

[5] *Smith* v. *Dirckx* 223 S.W. 104. The suit was brought by a real estate dealer of Jefferson City, Cole County, by the name of Smith, against the county collector for a refund of the excess paid under the terms of the amended law.

The income tax law was further amended by the last legislature,[1] which reduced the rate from $1\frac{1}{2}$ per cent to 1 per cent on net incomes beginning with the year 1922. This rate applies to both personal incomes and to corporation incomes. A proposal to raise the exemption from $1,000 to $1,500 for single persons, and for others in proportion, was defeated.

III. OUTSTANDING FEATURES OF THE MISSOURI INCOME-TAX LAW

1. *The tax as it applies to incomes of individuals.*—The law applies to every citizen of the state whether residing in the state or abroad, to every person living in the state even though he may not be a citizen of Missouri, and to the income from all property owned and from every business, trade, or profession carried on in the state by persons living elsewhere. Beginning with the year 1922, the rate will be 1 per cent upon the taxable income of any person subject to the tax. The same rate and the same exemptions apply to residents and non-residents alike.

Gross income, as used in the law, includes all income, gains, and profits arising or accruing from all sources during the year for which the return is made, with two exceptions, viz., (*a*) the value of property acquired by gift, bequest, devise, or descent during the year, and (*b*) the proceeds of life insurance policies paid upon the death of the person insured to beneficiaries, and payments made by or credited to the insured, on life insurance, endowment, or annuity contracts, etc., are not included as part of the gross income.

Net income consists of total gains, profits, and income derived from all sources (i.e., gross income), minus a number of specifically enumerated exemptions and deductions, viz., expenses actually paid for carrying on the business; all interest paid within the year on personal indebtedness of the taxpayer incurred in the conduct of business; "all national, state, county, school, and municipal taxes paid within the year (not including those assessed against local benefits)"; losses actually sustained not compensated by insurance; a reasonable allowance for exhaustion, wear, and tear of property caused by its use; "the amount

[1] Amendment at the Special Session, August 3, 1921.

included in gross income received as dividends upon the stock or upon the net earnings, of any corporation, joint-stock company, association, or insurance company which is taxable upon its net income." None of these deductions may include money paid out as gifts, donations or endowments. In addition to these deductions a resident of Missouri is allowed credit for that portion of his income, the tax upon which has been withheld at the source, and he receives credit for taxes paid in any other state upon income from property located there. However, such credit is limited to the amount such taxes would have been, if they had been assessed and levied at the rate of such taxation prescribed by the Missouri tax. The law does not require that the deduction be limited to the income derived from such property, but states that the tax "shall be deducted from the amount of the income tax required by this act."[1]

A single person, who is a resident of the state, is allowed an exemption of $1,000, while a married couple is allowed an exemption of $2,000 and $200 additional for every child under eighteen years of age or incapable of self-support because mentally or physically defective. A non-resident individual receives the benefit of these exemptions provided he files with the assessor a return of his total income, received from all sources in the state, in the manner prescribed by law. If he fails to file his return the collector collects the tax on such income, and all property belonging to such non-resident individual is liable to distraint for the tax.

In calculating his income, an individual must include the share to which he is entitled of the gains and profits of all corporations, joint stock companies or associations, insurance companies, etc., whether these gains and profits are so divided or distributed or not. The state auditor is the judge as to whether the funds so held back should have been distributed, or, in other words, whether the individual should count the undivided profits as a part of his gross income. Partnerships, as such, are not taxable under the income tax law, and are required to make

[1] State of Missouri Income Tax Law, etc., compiled by George E. Hackmann, State Auditor, November 2, 1921, p. 6, Sec. 13110, subsection 11.

returns only when requested to do so by the state auditor or the assessor for the county or township in which the partnership has its principal place of business. The profits of a partnership must be included in the individual returns of the partners.

2. *The tax as it applies to the incomes of incorporated businesses.*—The law applies to every corporation, joint-stock company or association, and every insurance company organized in the state, no matter how created or organized except those specifically exempted. They must pay upon their entire net income arising or accruing from all sources during the preceding calendar or fiscal year as the case may be. Beginning with 1922 the rate is to be 1 per cent. In the case of foreign corporations the tax is levied upon their net income accruing from business transacted and capital invested within the state during the year. This income includes interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, and includes the income derived from dividends on capital stock or from net earnings of resident corporations, joint-stock companies or associations whose net income is taxable under this law.[1] If the dividend is paid in stock, it is counted at its cash value.

In order to secure uniformity in determining gross income, the state auditor has set certain rules for the various business organizations; e.g., the gross income of banks is regarded as consisting of the total revenue derived from the operation of the business, including income, gains, or profits from all other sources, as shown by the entries on the books of account, within the calendar or fiscal year for which the return is made. The gross income of manufacturing concerns consists of the total sales of manufactured goods during the year covered by the return, increased or decreased by the gain or loss as shown by the inventories of finished and unfinished products, raw material, etc., at thebeg inning and end of the year. To this amount should be added the income, gains, or profits from all other sources as shown books by the of account. The gross income of mercantile companies consists of the total merchandise sales during the

[1] Amendments 1921, Section 13112.

year, increased or decreased by the gain or loss as shown by the inventories of merchandise at the beginning and end of the year for which the return is made; to this account should be added the income, gains or profits derived from all other sources as shown by the books of account.[1]

It will be seen from the foregoing illustrations that gross income includes operating revenues plus income, gains, or profits from all other sources, such as rentals, royalties, interest, and dividends from stock owned in other corporations and appreciation in values of assets, if taken up on the books of account as gain, also profits made from the sale of assets, investments, etc.

The net income is computed by deducting from the gross income certain specifically enumerated items, e.g., ordinary and necessary expenses, losses sustained within the year, depreciation, interest accrued and paid within the year to an amount equal to such part of the indebtedness as not to exceed one-half of the sum of its interest-bearing indebtedness and its paid-up capital stock outstanding at the close of the year. If there is no capital stock there is substituted in its place the amount of capital employed in the business at the close of the year. In case of indebtedness secured wholly by collateral the subject of sale in ordinary business of the corporation, the interest so paid on this kind of indebtedness may be charged to expense. All sums paid within the year for taxes imposed under the authority of the United States or any state or territory or imposed by the government of any foreign country may be deducted.

Commissions allowed salesmen, paid in stock, may be deducted as expense if so charged on the books at the actual value of such stock. Amounts paid for pensions to retired employees, or to their families, or to others dependent upon them, or on account of injuries received by employees, are proper deductions as ordinary and necessary expenses, but not so with gifts and gratuities to employees.

In the case of foreign corporations the net income is derived by making certain deductions, such as expenses, losses, etc.,

[1] *Income Tax Regulations*, pp. 31, 33, 34.

as listed for domestic corporations. In the case of interest paid on indebtedness, the amount of indebtedness must not exceed that proportion of the sum of (*a*) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of the capital employed in the business at the close of the year, and (*b*) one-half of the interest-bearing indebtedness then outstanding, which the gross amount of its income for the year from business transacted and capital invested within the state bears to the gross amount of the income derived from all sources within and without the state. Putting the above in the form of an algebraic statement, we have:

$$\text{Capital stock plus } \frac{\text{Interest-bearing indebtedness}}{2} \text{ times } \frac{\text{Gross income in Missouri}}{\text{Total gross income from all sources}}$$

equals the amount of indebtedness upon which the interest charges—at the current rate of interest—may be deducted.

In the case of charges to expense allowed foreign corporations, the principle established is that only those expenses which were incurred in carrying on the business in Missouri shall be allowed, in the case of a company doing both foreign and domestic business. One way of determining this expense is to take such proportion of the aggregate charges as the gross income from business done and capital invested in Missouri bears to the aggregate income within and without the state, e.g.,

$$\frac{\text{Gross income from Missouri}}{\text{Total gross income from all sources}} \text{ times aggregate charges equals the}$$

charges allowable for business done in the state.

All corporations are required to paste or attach to their income tax returns, their profit and loss statement, showing their net gain or loss as per their books.

3. *Administrative features of the income-tax law.*—Each person subject to the tax files a return of income under oath, on or before March 1 of each year for the preceding year. The

return is made on a form showing three specific items, viz., (*a*) all income received from each specific source and the total amount; (*b*) all the separate items of deduction claimed under the law; (*c*) the amount of specific exemption claimed. These blank forms are secured from the assessor of the district—Missouri is divided into 115 districts, 114 counties, and St. Louis, and filed with assessor on or before March 1. The names of all persons having taxable incomes are kept in a book known as the Income Assessment Book, one for each district. The assessment is to be completed before March 1, and forthwith certified to the county clerk or city auditor, who must make his report to the county collector on or before May 1, and the taxes must be collected and paid on or before June 1, to the county collector and by him remitted monthly to the state treasury.

Fraudulent returns by individuals are penalized by becoming subject to twice the rate otherwise charged. A failure or refusal to report by a corporation is penalized by a specific fine of not less than $100 and not to exceed $5,000 at the discretion of the Court. For a false report by an officer of a corporation a fine of not to exceed $2,500 or one year imprisonment or both may be imposed.

IV. THE REVENUE PRODUCING POWER OF THE INCOME TAX

On January 31, 1921, the state of Missouri had twenty-one sources of income or revenue. The following table taken from the *Report of the State Auditor to the Fifty-first General Assembly*, for the biennial period beginning January 1, 1919, and ending December 31, 1920, shows the total revenues and the income tax revenue for the years 1917, 1918, 1919, 1920, 1921, and that estimated for 1922:

Years	Total Receipts	Income Tax
1917 and 1918	$14,821,733.47*	$ 201,885.86*
1919	24,255,083.71*	484,898.80
1920	....	3,298,340.83
1921	14,867,000.00†	4,700,000.00‡
1922	14,863,000.00†	4,500,000.00†

* For the biennial period. † Estimated by the state auditor.
‡ Actual receipts for the year.

The failure of the 1917 tax to produce much revenue—only $201,885.86—was due to a lack of administrative machinery and to the offset which was allowed for property taxes. According to the auditor's estimates, the returns for 1921 and 1922 will put the income tax ahead of any other single source of revenue, viz., $9,000,000 for the biennial period. Evidently his estimates are holding good, especially for the income tax as it is stated that the state collected $4,700,000 as the income tax for 1921. The auditor's office states that the "tax has been very satisfactory as an income producer."

In view of the fact that the income tax rate was reduced to 1 per cent for the year 1922 and thereafter, it is quite possible that the total receipts will fall below that estimated by the auditor. In 1921 the income tax was accounting for about one-third of the revenue of the state. The income tax revenue goes into the general tax fund and is apportioned in the same manner as the proceeds of the other taxes. There does not seem to be any serious objection to the administration of the tax. It causes the taxpayer very little more trouble than the payment of his regular taxes, in that he deals with the same officials. The state officials seem to be fairly well pleased with the yield of the tax. However, if we compare Missouri with Wisconsin, we see that Missouri's income tax is not nearly as productive as that of Wisconsin. In 1918 Wisconsin received $6,951,483 from her income tax. The amount of personal net income reported for 1917 for the state of Missouri was more than 50 per cent greater than the corresponding amount reported for Wisconsin and the net income of Missouri corporations was more than double the net income of Wisconsin corporations.[1]

While the law seems to be fairly successful, there seems to be little doubt that the yield could be increased and the administration improved by a few simple changes, viz., (*a*) a change from the present flat rate on individual incomes to a progressive rate;[2] (*b*) an increase of the present rate of 1 per cent to 2 per

[1] Alzada Comstock, "Fiscal Aspects of State Income Taxes," *American Economic Review*, X, No. 2, 26.

[2] It is possible that this change might require an amendment to the state constitution.

cent on the net income of corporations; (*c*) centralization of the administration of the tax in a State Tax Commission with power to appoint and remove local tax officials; (*d*) after the cost of collecting the tax has been deducted, apportionment of the remaining portion of the tax among the various governmental units according to some fixed ratio.

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